FENNEMORE CRAIG, P.C.

2394 East Camelback Road, Suite 600
Phoenix, Arizona 85016-3429
(602) 916-5000

RECEIVED
2015 JUN 10 P 2:32
AZ CORP COMMISSION
DOCKET CONTROL

Sarah A. Strunk
Direct Phone: (602) 916-5327
sstrunk@fclaw.com

Aaron Cain
Direct Phone: (602) 916-5318
acain@fclaw.com

Law Offices
Denver (303) 291-3200
Las Vegas (702) 692-8000
Nogales (520) 281-3480
Phoenix (602) 916-5000
Reno (775) 788-2200
Tucson (520) 879-6800

ORIGINAL

Arizona Corporation Commission
DOCKETED
JUN 10 2015
DOCKETED BY

June 10, 2015

Arizona Corporation Commission
Securities Division
1300 West Washington Street, Third Floor
Phoenix, AZ 85007

Re: Docket for Commission's Inquiry into Possible Rulemaking To Amend the Commission's Securities Regulation Investment Management Rules Related to Licensing Exemption for Investment Advisers to Private Funds Document No.: S-00000E-15-0129

Dear Commissioners:

Private equity and venture capital provide a crucial source of financing for businesses in Arizona. The growth enabled by this source of financing benefits our economy, increases the tax base and produces the jobs we need to meet the demands of our growing state. We believe it is important to update our legal framework for the regulation of the managers of these funds to remove the current disincentive to the formation and operation of these funds within the State of Arizona.

In 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Dodd-Frank substantially revised many federal financial services and securities laws, impacting the regulation of investment advisers. An "investment adviser" includes anyone who advises others as to the value or advisability of investing in, purchasing or selling securities for compensation or as part of a regular business. In simple terms, almost anyone that manages or advises a private equity or venture capital fund is subject to regulation as an "investment adviser".

Registration with the SEC and/or state securities regulators is a process that many fund managers (especially managers of relatively small funds) deem too costly or burdensome. Prior to Dodd-Frank, investment advisers with fewer than 15 clients and who did not hold themselves out to the public as an investment adviser were exempt from federal registration. Many private equity and venture capital funds relied on this exemption, which was also carried through to many states, although not in Arizona. After the passage of Dodd-Frank, the SEC promulgated rules that eliminated this 15-client "private adviser" exemption, replacing it with an exemption for advisers who: (a) solely advise venture capital funds; or (b) advise "qualifying private funds"

with less than $150 million in assets under management. A qualifying private fund is a fund that is exempt under the Investment Company Act of 1940. An adviser who meets the requirements of this rule is considered an "exempt reporting adviser", because they are still subject to limited public reporting requirements.

Because most states linked a 15-client "private adviser" exemption to the corresponding federal exemption, Dodd-Frank's elimination of the 15-client "private adviser" exemption also destroyed the state level registration exemption that many investment advisers had previously relied upon.

In 2011, shortly after the adoption of the new rules by the SEC, the North American Securities Administrators Association ("NASAA") adopted a model state-level registration exemption corresponding to the new standards created by Dodd-Frank for investment advisers to private funds. This NASAA model rule is largely predicated on advisers to funds where the financial net worth of the investors in these funds make it more likely that the investors can protect their own interests -- thus minimizing the need for state oversight. The adoption of this model rule helped establish a regulatory structure that efficiently enables fund managers to comply with both federal and state level exemptions from registration, and provided a basis for generally consistent standards among the various states. Most other states have already responded by updating their regulatory framework to incorporate all or some form of the NASAA model rule. Only a few states, including Arizona, have not adopted any further exemptions.[1]

The Arizona Investment Management Act provides that no investment adviser may conduct business in this state unless they are licensed under Arizona law, are a federally licensed adviser or are exempt. Currently, the only exemptions for investment advisers are found in the Arizona Investment Management Act. An exemption exists only for advisers without a place of business in this state and whose only clients located in this state: (a) are generally investment advisers, dealers, banks, insurance companies or certain employee benefit plans, or (b) are fewer than 6.

Simply put, unlike most other states, no exemption from registration currently exists for any person who wants to form or manage a private equity or venture capital fund within the State of Arizona and supply capital to local businesses. As a result, unless Arizona takes action to update its regulatory framework, Arizona will maintain a remarkable regulatory deterrent that will continue to inhibit the local formation, management and supply of capital that is so important to its growth.

---

[1] Alaska, Alabama, Arizona, Arkansas, Delaware, Hawaii, Idaho, Kentucky, Mississippi, Montana, Nebraska, Nevada, New Hampshire, North Dakota, South Carolina, South Dakota, Utah and West Virginia.

A draft of a proposed exemption for Arizona based on the NASAA model rule prepared by Aaron Cain is attached.

Sincerely,

FENNEMORE CRAIG, P.C.

Sarah A. Strunk

Aaron Cain

Exemption for investment advisers to qualifying private funds.

1. For purposes of this paragraph X, the following definitions shall apply:

   (a) "Private fund adviser" means an investment adviser who provides advice solely to one or more qualifying private fund(s).

   (b) "Qualifying private fund" means an issuer that qualifies for the exclusion from the definition of an investment company under one or more of sections 3(c)(1), 3(c)(5) and 3(c)(7) of the investment company act of 1940.

   (c) "Retail buyer fund" means a qualifying private fund that is neither (i) a venture capital company, nor (ii) a qualifying private fund that qualifies for the exclusion from the definition of an investment company under 3(c)(7) of the investment company act of 1940.

   (d) "Venture capital company" means an entity that satisfies one or more of the conditions below:

      (i) the entity is a "venture capital fund" as defined in rule 203(l)-1 adopted by the Securities and Exchange Commission under the investment advisors act of 1940; or

      (ii) the entity is a "venture capital operating company" as defined in rule 2510.3-101(d) adopted by the U.S. Department of Labor under the Employee Retirement Income Security Act of 1974 (29. C.F.R. 275.203(l)-1); or

      (iii) on at least one occasion during the annual period commencing with the date of its initial capitalization, and on at least one occasion during each annual period thereafter, at least fifty percent of its assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, are venture capital investments or derivative investments.

   (e) "Venture capital investment" means an acquisition of securities in an operating company as to which the investment adviser, the entity advised by the investment adviser, or an affiliated person of either has or obtains management rights.

   (f) "Derivative investment" means an acquisition of securities by a venture capital company in the ordinary course of its business in exchange for an existing venture capital investment, either (i) upon the exercise or conversion of the existing venture capital investment or (ii) in connection with a public offering of securities or the merger or reorganization of the operating company to which the existing venture capital investment relates.

   (g) "Management rights" means the right, obtained contractually or through ownership of securities, either through one person alone or in conjunction with one or more persons acting together or through an affiliated person, to substantially participate in, to substantially influence the conduct of, or to provide (or to offer to provide) significant guidance and counsel concerning, the management, operations or business objectives of the operating company in which the venture capital investment is made.

(h) An "operating company" means an entity that is primarily engaged, directly or through a majority owned subsidiary or subsidiaries, in the production or sale (including any research or development) of a product or service other than the management or investment of capital, but does not include an individual or sole proprietorship.

(i) "Affiliated person" means a person that controls, is controlled by, or is under common control with the other specified person(s).

(j) "Control" means possessing, directly or indirectly, the power to direct or cause the direction of management and policies.

(k) "Advisory affiliate" means an "advisory affiliate" as defined in the Glossary of Terms to Form ADV (Uniform Application for Investment Adviser Registration (17 C.F.R. § 279.1)) or its successor form.

2. Subject to the additional requirements of paragraph X.2., a private fund adviser shall not be required to be licensed under this chapter if the private fund adviser satisfies each of the following conditions:

(a) neither the private fund adviser nor any of its advisory affiliates are subject to an event that would disqualify an issuer under Rule 262 of SEC Regulation A, 17 C.F.R. § 230.262;

(b) the private fund adviser to a qualifying private fund that is not a venture capital company files with the commission each report and amendment thereto that the investment adviser is required to file with the Securities and Exchange Commission pursuant to SEC Rule 204-4 (17 C.F.R. § 275.204-4) adopted by the Securities and Exchange Commission under the investment advisors act of 1940.

(c) the private fund adviser for a qualifying private fund that is not a venture capital company has paid a $125 fee for each calendar year in which it relies on the exemption provided in this paragraph X.

3. In order to qualify for the exemption described in paragraph X.2., a private fund adviser who advises at least one retail buyer fund shall, (except as otherwise provided in paragraph 9), in addition to satisfying each of the conditions specified in paragraphs X.2.(a) through X.2.(c), comply with the following requirements with respect to each retail buyer fund advised by the private fund adviser:

(a) The private fund adviser shall advise only those retail buyer funds whose outstanding securities (other than short-term paper) are beneficially owned entirely by:

(i) persons who, at the time the securities were sold, either (A) are reasonably believed to meet the definition of "accredited investor" in rule 501(a) of Regulation D adopted by the Securities and Exchange Commission under the Securities Act of 1933, as amended (17 C.F.R. § 230.501(a))), or (B) were managers, directors, officers or employees of the private fund adviser; or

(ii) any person that obtains the securities through a transfer not involving a sale of that security.

(b) At or before the time of purchase of any ownership interest in a retail buyer fund, the private fund adviser shall disclose in writing to the purchaser of such ownership interest (i) all services, if any, to be provided by the investment adviser to a beneficial owner of the fund, and to the fund itself, and (ii) all duties, if any, the investment adviser owes to a beneficial owner of the fund, and to the fund itself; provided however that compliance with this paragraph X.3.(b) shall not relieve the private fund adviser of any disclosure obligation under any other state or federal law.

(c) The private fund adviser shall obtain on an annual basis audited financial statements of each retail buyer fund with assets (valued at cost) in excess of $25,000,000 (individually or collectively with all other retail buyer funds that are affiliated persons) that is advised by the private fund adviser, and shall deliver a copy of such audited financial statements to each beneficial owner of the fund.

4. If a private fund adviser is registered with the Securities and Exchange Commission, the adviser shall not be eligible for this exemption.

5. A person is not required to be licensed or make a notice filing under this chapter if he or she is employed by or associated with an investment adviser that is not required to be licensed under this chapter pursuant to paragraph X.2. and does not otherwise act as an investment adviser representative.

6. The report described in paragraph X.2.(b) above shall be filed electronically through the IARD. A report shall be deemed filed when the report and the fee required by paragraph X.2.(c) are filed and accepted by the IARD on the state's behalf.

7. An investment adviser who becomes ineligible for this exemption must comply with all applicable laws and rules requiring licensing or notice filing within ninety days after the date on which the investment adviser's eligibility for this exemption ceases.

8. Paragraph X.2.(a) shall not apply upon a showing of good cause and without prejudice to any other action of the commission, if the commission determines that it is not necessary under the circumstances that an exemption be denied.

9. An investment adviser to a retail buyer fund that existed prior to the effective date of this exemption and that does not satisfy the conditions set forth in paragraph X.3.(a) on the effective date may nevertheless be eligible for the exemption contained in subsection X.2. if the following conditions are satisfied:

(a) as of the effective date of this exemption, the retail buyer fund ceases to sell interests to investors other than those described in paragraph X.3.(a)(i);

(b) the investment adviser discloses in writing the information described in paragraph X.3.(b) to every beneficial owner of the fund within ninety days after the effective date of this exemption;

(c) for every fiscal year ending after the effective date of this exemption, the investment adviser delivers audited financial statements to each beneficial owner as required by paragraph X.3.(c); and

(d) as of the effective date of this regulation, the investment adviser delivers audited financial statements as required by paragraph X.3.(c).

10444447